

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

Years Ended June 30, 2008 and 2007

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

Years Ended June 30, 2008 and 2007

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITOR'S REPORT	1
MANAGEMENT'S DISCUSSION AND ANALYSIS	3
FINANCIAL STATEMENTS	
Balance Sheets	10
Statements of Revenues, Expenses, and Changes in Net Assets	12
Statements of Cash Flows	13
Notes to Financial Statements	15
SUPPLEMENTARY INFORMATION	
Schedule 1 - Patient Service Revenue	29
Schedule 2 - Provision for Contractual Adjustments and Bad Debts	30
Schedule 3 - Other Operating Revenue	31
Schedule 4 - Salaries and Benefits	32
Schedule 5 - Medical Supplies and Drugs	33
Schedule 6 - Other Supplies	34
Schedule 7 - Other Expenses	35
INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS	36

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

Years Ended June 30, 2008 and 2007

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITOR'S REPORT	1
MANAGEMENT'S DISCUSSION AND ANALYSIS	3
FINANCIAL STATEMENTS	
Balance Sheets	10
Statements of Revenues, Expenses, and Changes in Net Assets	12
Statements of Cash Flows	13
Notes to Financial Statements	15
SUPPLEMENTARY INFORMATION	
Schedule 1 - Patient Service Revenue	29
Schedule 2 - Provision for Contractual Adjustments and Bad Debts	30
Schedule 3 - Other Operating Revenue	31
Schedule 4 - Salaries and Benefits	32
Schedule 5 - Medical Supplies and Drugs	33
Schedule 6 - Other Supplies	34
Schedule 7 - Other Expenses	35
INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS	36

**BURK:PEARLMAN
NEBBEN & HUGGINS, PLLC**
CERTIFIED PUBLIC ACCOUNTANTS

7030 LEE HIGHWAY • SUITE 202 • CHATTANOOGA, TENNESSEE 37421
TELEPHONE: (423) 490-8500 • FAX: (423) 490-4400
admin@bprhcpa.com

INDEPENDENT AUDITOR'S REPORT

To the Board of Trustees of
Rhea Medical Center (a component unit of Rhea County, Tennessee)

We have audited the accompanying financial statements of Rhea Medical Center (a component unit of Rhea County, Tennessee) as of and for the years ended June 30, 2008 and 2007, which collectively comprise the Medical Center's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Rhea Medical Center's (a component unit of Rhea County, Tennessee) management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Rhea Medical Center (a component unit of Rhea County, Tennessee) as of June 30, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 24, 2008, on our consideration of Rhea Medical Center's (a component unit of Rhea County, Tennessee) internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over

financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The management's discussion and analysis on pages 3 through 8 is not a required part of the accompanying financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The schedules listed as supplementary in the table of contents are presented for purposes of additional analysis and are not a required part of the financial statements of Rhea Medical Center (a component unit of Rhea County, Tennessee). Such information has been subjected to the auditing procedures applied in the audits of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

Burr, Pearlman, Nebeker & Huggins, PLLC

Chattanooga, Tennessee
November 24, 2008

RHEA MEDICAL CENTER
A COMPONENT UNIT OF RHEA COUNTY, TENNESSEE
MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of Rhea Medical Center's (the Medical Center's) financial performance provides an overview of the Medical Center's financial activities for the fiscal years ended June 30, 2008 and 2007. Please read it in conjunction with the Medical Center's financial statements, which begin on page 9.

Financial Highlights

- On August 23, 2007 the Medical Center opened its new facility. The new facility has had a major impact on the financials of the Medical Center and is highlighted in this report.
- The Medical Center's net assets increased in each of the past two years with a \$1,332,842 or 10% increase in 2008 and a \$2,013,838 or 17% increase in 2007. The Medical Center reported operating income in both 2008 and 2007. Operating revenues increased 18% over 2007, while operating expenses increased at a rate of 20% in 2008.

Using This Annual Report

The Medical Center's financial statements consist of three statements – a Balance Sheet; a Statement of Revenues, Expenses, and Changes in Net Assets; and a Statement of Cash Flows. These financial statements and related notes provide information about the activities of the Medical Center, including resources held by the Medical Center.

The Balance Sheet and Statement of Revenues, Expenses and Changes in Net Assets

One of the most important questions asked about the Medical Center's finances is, "Is the Medical Center as a whole better or worse off as a result of the year's activities?" The Balance Sheet and the Statement of Revenues, Expenses, and Changes in Net Assets report information about the Medical Center's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Medical Center's net assets and changes in them. Net assets, which is the difference between assets and liabilities, is one way to measure the Medical Center's financial health, or financial position. Over time, increases or decreases in the Medical Center's net assets indicate whether its financial health is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as changes in the Medical Center's patient base and measures of the quality of service it provides to the community, as well as local economic factors to assess the overall health of the Medical Center.

RHEA MEDICAL CENTER
A COMPONENT UNIT OF RHEA COUNTY, TENNESSEE
MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

The Statement of Cash Flows

The final required statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing and financing activities. It provides answers to such questions as "Where did cash come from?" "What was cash used for?" and "What was the change in cash balance during the reporting period?"

The Medical Center's Net Assets

The Medical Center's net assets are the difference between its assets and liabilities reported in the Balance Sheet on page 10 and 11. The Medical Center's net assets increased in each of the past two years with a \$1,332,842 or 10% increase in 2008 and a \$2,013,838 or 17% increase in 2007. See Exhibit One for an illustration.

Exhibit One: Assets, Liabilities, and Net Assets

	<u>2008</u>	<u>2007</u>
Assets:		
Current assets	\$10,119,566	\$ 8,119,787
Capital assets, net,	31,872,274	27,158,631
Non-current cash and investments	253,558	242,806
Other assets	399,376	372,246
Total assets	<u>\$42,644,774</u>	<u>\$35,893,470</u>
Liabilities		
Current liabilities	\$ 2,433,772	\$ 2,692,638
Long-term debt outstanding	24,857,518	19,180,396
Other liabilities	24,452	24,246
Total liabilities	<u>\$27,315,742</u>	<u>\$21,897,280</u>
Net assets:		
Invested in capital assets, net of related debt	\$ 6,784,618	\$ 7,767,764
Unrestricted	8,315,308	6,009,866
Unrestricted-Board Designated	229,106	218,560
Total Net Assets	<u>\$15,329,032</u>	<u>\$13,996,190</u>

RHEA MEDICAL CENTER
A COMPONENT UNIT OF RHEA COUNTY, TENNESSEE
MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

Assets increased by \$6,751,304 or 19% during 2008. A significant component of the change in the Medical Center's assets is the increase in capital assets. During 2008, gross capital assets increased \$4,713,643. The increase in capital assets is due to the completion of the replacement facility and the purchase of new equipment and furnishings for the facility. The replacement facility was completed in August 2007. Current assets increased \$1,999,779 due to a \$2,034,010 increase in cash (see Statements of Cash Flows for a detail of the changes in cash) and a \$826,250 increase in estimated third party settlements (see Note C to the financial statements for a summary of the basis of reimbursement with major third party payors). These increases in current assets have been partially offset by a \$1,238,026 decrease in prepaid expenses. The decrease in prepaid expenses is due to the payout of escrow accounts held for contractors until the completion of the building project. Liabilities increased by \$5,418,462 during 2008. Current liabilities decreased \$258,866 due to a \$1,657 decrease in estimated third party settlements (see Note C to the financial statements for a summary of the basis of reimbursement with major third party payors) and a \$299,062 decrease in accounts payable. The decrease in accounts payable was due to the completion of the construction project. The increase in long-term debt relates to the financing of the replacement facility project. During 2008, \$5,222,614 of funds were drawn from a loan agreement for the construction of the replacement facility. The total available financing for the new facility was \$24,100,000 as detailed in the Note H to the financial statements. As of June 30, 2008 the entire \$24,100,000 has been drawn from the funds.

Operating Results and Changes in the Medical Center's Net Assets

The Medical Center's net assets increased by \$1,332,842 or 10% in 2008 and \$2,013,838 or 17% increase in 2007, as shown in Exhibit 2. The increase in 2008 is primarily due to the increases discussed above. Operating income decreased in 2008 by \$87,953 or 5% and decreased in 2007 by \$55,357 or 3%, respectively.

RHEA MEDICAL CENTER
A COMPONENT UNIT OF RHEA COUNTY, TENNESSEE
MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

Exhibit 2: Operating Results and Changes in Net Assets

	<u>2008</u>	<u>2007</u>
OPERATING REVENUES:		
Net patient service revenue	\$22,030,134	\$18,750,930
Other revenue	<u>211,545</u>	<u>176,837</u>
TOTAL OPERATING REVENUES	<u>22,241,679</u>	<u>18,927,767</u>
OPERATING EXPENSES:		
Salaries and benefits	10,904,964	9,657,293
Medical supplies and drugs	1,571,789	1,578,854
Other supplies	736,542	567,575
Insurance	537,037	466,893
Depreciation	1,638,616	670,243
Other expenses	<u>5,075,602</u>	<u>4,121,827</u>
TOTAL OPERATING EXPENSES	<u>20,464,550</u>	<u>17,062,685</u>
OPERATING INCOME	<u>1,777,129</u>	<u>1,865,082</u>
NONOPERATING REVENUES (EXPENSES)		
Interest income	106,184	135,753
Interest expense	(640,725)	(18,436)
Noncapital contribution	35,954	5,797
Noncapital grants	<u>54,300</u>	<u>25,642</u>
TOTAL NONOPERATING REVENUES (EXPENSES)	<u>(444,287)</u>	<u>148,756</u>
EXCESS OF REVENUES OVER EXPENSES AND INCREASE IN NET ASSETS	1,332,842	2,013,838
Net assets at beginning of year	<u>13,996,190</u>	<u>11,982,352</u>
Net assets at end of year	<u>\$15,329,032</u>	<u>\$13,996,190</u>

RHEA MEDICAL CENTER
A COMPONENT UNIT OF RHEA COUNTY, TENNESSEE
MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

Operating Income

The first component of the overall change in the Medical Center's net assets is its operating income – generally the difference between net patient service revenues and the expenses incurred to perform those services. In the past two years, the Medical Center has reported operating income.

The primary components of the operating income in 2008 are:

- Net patient service revenue increased by \$3,279,204 or 17.5% in 2008. The increase in net patient service revenue is due to the increase in patient volume. Adjusted admissions increased by 841 or 14%. This increase in patient volume is due to the recruitment of primary care physicians and the impact of the new facility. Net patient service revenue increased by \$433,516 or 2.4% in 2007.
- Salaries and related benefits increased by \$1,247,671 or 13% to provide additional staff for the increase in patient volume. Staffing levels were also increased during the first quarter for the move to and opening of the new facility. Salaries and related benefits increased by \$634,906 or 7% in 2007.
- Depreciation expense increased by \$968,373 in 2008 due to depreciation recorded on the new facility and new equipment (see Note F for a summary of changes in capital assets).
- Other expenses increase by \$953,775. Other expense categories with the largest increases include utilities (\$359,486 increase due to operating two facilities), contract services (\$251,497 increase due to contract labor for opening the new facility) and outside services (\$68,062 for new speech therapy service).
- Bad debt expense, included in net patient service revenue, increased by \$514,256 or 18%. This increase is due to the loss of TennCare coverage by individuals that were dropped from the State of Tennessee's Medicaid program. Bad debt expense increased by \$794,424 or 39% in 2007. In 2008, bad debt as a percent of patient revenue was 8.3% compared to 7.9% for 2007.

Nonoperating Revenues

Nonoperating revenues for 2008 includes \$640,725 in interest expense. The increase in interest expense is due to the financing of the new facility as discussed in Note H of the Financial Statements.

RHEA MEDICAL CENTER
A COMPONENT UNIT OF RHEA COUNTY, TENNESSEE
MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

The Medical Center's Cash Flows

Changes in the Medical Center's cash flows are consistent with changes in prepaid assets; property, plant, and equipment, net; repayments of debt; operating income and nonoperating income, as discussed earlier.

Capital Asset and Debt Administration

Capital Assets. As of June 30, 2008, the Medical Center had \$31,872,274 invested in capital assets, net of accumulated depreciation, as detailed in Note F to the financial statements. During fiscal year 2008, the Medical Center purchased equipment and other depreciable assets of \$6,346,010 (reduced by \$1,632,368 in related depreciation expense on the balance sheet). Increase in capital assets is due to the construction of the replacement facility.

Debt. In 2007 the Medical Center entered a capital lease to purchase a MRI machine. The MRI lease has a carrying value of \$685,262 at June 30, 2008. In 2007, the Medical Center entered a capital lease to purchase a CT system. The CT system lease has a carrying value of \$302,294 at June 30, 2008. In 2006, the Medical Center obtained funding of up to \$24,100,000 to construct a replacement facility as detailed in Note H to the financial statements.

Other Economic Factors

The current economic situation that the country is facing could have a negative impact on the local economy. If companies in Rhea County lay off employees then the Medical Center could see an increase in uninsured patients which would lead to higher bad debt expense and charity care.

Due to both the national and local shortages of healthcare professionals, the Medical Center faces stiff competition in retaining and the recruitment of new employees. Management focuses on this issue in a number of ways including by meeting with local healthcare education programs to encourage student outplacement, offering scholarships to students in healthcare careers, monitoring compensation trends and adjusting compensation as necessary.

RHEA MEDICAL CENTER
A COMPONENT UNIT OF RHEA COUNTY, TENNESSEE
MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

Contacting the Medical Center's Financial Management

This financial report is designed to provide our patients, suppliers, creditors and other stakeholders with a general overview of the Medical Center's finances and to show the Medical Center's accountability for the money it receives. Any questions about this report or requests for additional financial information should be directed to Rhea Medical Center, Department of Finance, 9400 Rhea County Highway, Dayton, Tennessee 37321.

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

BALANCE SHEETS

June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
ASSETS		
CURRENT ASSETS		
Cash	\$ 4,829,700	\$ 2,795,590
Patient accounts receivable, net of estimated uncollectibles of \$1,143,138 in 2008 and \$999,817 in 2007	3,641,095	3,346,310
Estimated third-party payor settlements	997,063	170,813
Inventories	419,556	329,767
Prepaid expenses	79,599	1,317,625
Other assets	<u>152,553</u>	<u>159,682</u>
TOTAL CURRENT ASSETS	<u>10,119,566</u>	<u>8,119,787</u>
NONCURRENT CASH AND INVESTMENTS		
Internally designated for capital acquisitions	229,106	218,560
Patient trust funds	22,956	22,669
Activity funds	<u>1,496</u>	<u>1,577</u>
TOTAL NONCURRENT CASH AND INVESTMENTS	<u>253,558</u>	<u>242,806</u>
CAPITAL ASSETS		
Land	2,362,514	2,362,514
Construction in progress	30,306	20,707,872
Depreciable capital assets, net of accumulated depreciation	<u>29,479,454</u>	<u>4,088,245</u>
TOTAL CAPITAL ASSETS, net	<u>31,872,274</u>	<u>27,158,631</u>
OTHER ASSETS		
Bond issuance costs	156,204	162,452
Other assets	<u>243,172</u>	<u>209,794</u>
TOTAL OTHER ASSETS	<u>399,376</u>	<u>372,246</u>
TOTAL ASSETS	<u>\$42,644,774</u>	<u>\$35,893,470</u>

See accompanying notes to financial statements.

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

BALANCE SHEETS

June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Current maturities of long-term debt	\$ 230,138	\$ 210,471
Accounts payable	827,661	1,126,723
Accrued payroll	634,803	559,795
Other accrued expenses	230,111	282,933
Estimated third-party payor settlements	<u>511,059</u>	<u>512,716</u>
TOTAL CURRENT LIABILITIES	<u>2,433,772</u>	<u>2,692,638</u>
LONG-TERM DEBT, net of current maturities	<u>24,857,518</u>	<u>19,180,396</u>
OTHER LIABILITIES		
Patient trust funds	22,956	22,669
Activity funds	<u>1,496</u>	<u>1,577</u>
TOTAL OTHER LIABILITIES	<u>24,452</u>	<u>24,246</u>
TOTAL LIABILITIES	<u>27,315,742</u>	<u>21,897,280</u>
NET ASSETS		
Invested in capital assets net of related debt	6,784,618	7,767,764
Unrestricted	8,315,308	6,009,866
Unrestricted-board designated	<u>229,106</u>	<u>218,560</u>
TOTAL NET ASSETS	<u>15,329,032</u>	<u>13,996,190</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$42,644,774</u>	<u>\$35,893,470</u>

See accompanying notes to financial statements.

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

Years Ended June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
OPERATING REVENUE		
Net patient service revenue	\$22,030,134	\$18,750,930
Other revenue	<u>211,545</u>	<u>176,837</u>
TOTAL OPERATING REVENUE	<u>22,241,679</u>	<u>18,927,767</u>
OPERATING EXPENSES		
Salaries and benefits	10,904,964	9,657,293
Medical supplies and drugs	1,571,789	1,578,854
Other supplies	736,542	567,575
Insurance	537,037	466,893
Depreciation	1,638,616	670,243
Other expenses	<u>5,075,602</u>	<u>4,121,827</u>
TOTAL OPERATING EXPENSES	<u>20,464,550</u>	<u>17,062,685</u>
OPERATING INCOME	<u>1,777,129</u>	<u>1,865,082</u>
NONOPERATING REVENUES (EXPENSES)		
Interest income	106,184	135,753
Interest expense	(640,725)	(18,436)
Noncapital contribution	35,954	5,797
Noncapital grants	<u>54,300</u>	<u>25,642</u>
TOTAL NONOPERATING REVENUES (EXPENSES), net	<u>(444,287)</u>	<u>148,756</u>
EXCESS OF REVENUES OVER EXPENSES AND INCREASE IN NET ASSETS	1,332,842	2,013,838
Net assets at beginning of year	<u>13,996,190</u>	<u>11,982,352</u>
Net assets at end of year	<u>\$15,329,032</u>	<u>\$13,996,190</u>

See accompanying notes to financial statements.

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

STATEMENTS OF CASH FLOWS

Years Ended June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from patients and third-party payors	\$17,551,200	\$14,577,936
Cash payments to suppliers for goods and services	(5,916,344)	(6,812,225)
Cash payments to employees for services	(8,456,026)	(7,448,926)
Other revenue	<u>211,545</u>	<u>176,837</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>3,390,375</u>	<u>493,622</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Noncapital grants and contributions	<u>90,254</u>	<u>31,439</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Interest paid on debt	(640,725)	(18,436)
Purchase of property and equipment	(5,789,753)	(19,148,870)
Payments on long-term debt	(334,293)	(150,099)
Proceeds from loan agreement	<u>5,222,614</u>	<u>17,195,253</u>
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	(<u>1,542,157</u>)	(<u>2,122,152</u>)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	106,184	135,753
Purchases of investments	(<u>10,546</u>)	(<u>8,923</u>)
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>95,638</u>	<u>126,830</u>
Net increase (decrease) in cash	2,034,110	(1,470,261)
Cash at beginning of year	<u>2,795,590</u>	<u>4,265,851</u>
Cash at end of year	\$ <u>4,829,700</u>	\$ <u>2,795,590</u>

See accompanying notes to financial statements.

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

STATEMENTS OF CASH FLOWS
(Continued)

Years Ended June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income	\$ 1,777,129	\$ 1,865,082
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	1,638,616	670,243
Provision for bad debts	3,356,243	2,841,987
Change in assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	(3,651,028)	(3,307,839)
Estimated third-party payor settlements	(826,250)	(16,146)
Inventories	(89,789)	(39,923)
Prepaid expenses	1,238,026	(1,232,084)
Other assets	(26,249)	115,357
Increase (decrease) in:		
Accounts payable	(46,852)	374,810
Accrued payroll	75,008	53,532
Other accrued expenses	(52,822)	17,612
Estimated third-party payor settlements	(1,657)	(849,009)
	<u>\$ 3,390,375</u>	<u>\$ 493,622</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Property and equipment purchases in accounts payable	\$ --	\$ 252,210
Capital lease	<u>\$ 808,468</u>	<u>\$ 398,580</u>

See accompanying notes to financial statements.

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

NOTES TO FINANCIAL STATEMENTS

NOTE A - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting entity. Rhea Medical Center (the Medical Center) is a public corporation. It was created on February 7, 1957, by an act of the State of Tennessee General Assembly to operate, control, and manage the general short-term hospital, intermediate care nursing home, and various health clinics. The Rhea County, Tennessee Board of County Commissioners appoints the Board of Trustee members of the Medical Center, and the Medical Center may not issue debt without the County's approval. For these reasons, the Medical Center is considered to be a component unit of Rhea County and is included as a discretely presented component unit in the basic financial statements of Rhea County, Tennessee (the County).

Enterprise fund accounting. The Medical Center uses the enterprise fund method of accounting whereby revenues and expenses are recognized on the accrual basis using the economic resources measurement focus.

Accounting standards. Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Medical Center has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

Use of estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Net patient service revenue. Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered and includes estimated retroactive revenue adjustments due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

NOTES TO FINANCIAL STATEMENTS
(Continued)

the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations. The 2007 net patient service revenue decreased \$31,860 due to prior year retroactive adjustments in excess of amounts previously estimated.

Revenue from the Medicare and Medicaid programs accounted for approximately 30 and 26 percent, respectively, for the year ended June 30, 2008, and 27 and 33 percent, respectively, for the year ended June 30, 2007, of the Medical Center's net patient service revenue. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

Charity care. The Medical Center provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Medical Center does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Operating revenues and expenses. The Medical Center's statement of revenues, expenses, and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services - the Medical Center's principal activity. Nonexchange revenues, including interest, grants, and contributions are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

Income taxes. The Medical Center, as a component unit of Rhea County, Tennessee, is exempt from federal and state income taxes.

Inventories. Inventories are stated at the lower of cost (first-in, first-out) or market.

Accounts receivable. Accounts receivable are stated at the amount the Medical Center expects to collect. The Medical Center maintains allowances for doubtful accounts for estimated losses resulting from the inability of its patients to make required

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

NOTES TO FINANCIAL STATEMENTS
(Continued)

payments. Management considers the following factors when determining the collectibility of specific patient accounts: payor credit-worthiness, past transaction history with the payor, current economic industry trends, and changes in payor payment terms. If the financial condition of the Medical Center's payors or patients were to deteriorate, adversely affecting their ability to make payments, additional allowances would be required. Based on management's assessment, the Medical Center provides for estimated uncollectible amounts through a charge to earnings and a credit to an allowance. Balances that remain outstanding after the Medical Center has used reasonable collection efforts are written off through a charge to the allowance and a credit to accounts receivable.

Noncurrent cash and investments. Internally designated for capital acquisition is cash and investments designated by the Board of Trustees for the creation of a health education library. Patients' personal assets and funds held by the Medical Center in an activity fund for the benefit of the patients are held in an agency capacity and are not available for Medical Center use. An offsetting asset and liability are recorded on the balance sheet.

Capital assets. Assets with a useful life of greater than one year and a cost of greater than \$5,000 are recorded as capital assets and are stated at cost. Depreciation is calculated over the estimated useful lives using the straight-line method. Expenditures for maintenance, repairs, renewals and betterments that do not significantly extend the useful lives of the assets are expensed as incurred. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the books, and any resulting gain or loss is reflected in income for the period.

A summary of estimated useful lives follows.

	<u>Estimated Useful Lives</u>
Land improvements	10 - 15 years
Buildings and improvements	10 - 50 years
Major moveable equipment	5 - 25 years
Fixed equipment	10 - 25 years

Costs of borrowing. Except for capital assets acquired through gifts, contributions, or capital grants, interest cost on borrowed funds during the period of construction of capital assets is

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

NOTES TO FINANCIAL STATEMENTS
(Continued)

capitalized as a component of the cost of acquiring those assets. Interest capitalized for 2008 and 2007 was \$124,557 and \$340,208, respectively.

Deposits. The Medical Center considers currency on hand and demand deposits with financial institutions to be cash. The Medical Center considers all highly liquid investments with original maturities of three months or less to be cash equivalents. State statutes authorize the Medical Center to invest in obligations of the U.S. Treasury, bank certificates of deposit, state approved repurchase agreements, and pooled investment funds, state or local bonds, rated A or higher by a nationally recognized rating service. There were no cash equivalents at June 30, 2008 and 2007.

Bond issuance costs. The costs incurred in connection with the issuance of the bonds will be amortized using the straight-line method over the term of the bonds.

Risk management. The Medical Center is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; and employee health benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

Net assets. Net assets of the Medical Center are classified in four components. *Net assets invested in capital assets net of related debt* consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. *Restricted expendable net assets* are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Medical Center. *Restricted nonexpendable net assets* equal the principal portion of permanent endowments. *Unrestricted net assets* are remaining net assets that do not meet the definition of *invested in capital assets net of related debt or restricted*. There were no restricted assets at June 30, 2008 or 2007.

NOTE B - DEPOSITS AND INVESTMENTS

Custodial credit risk - deposits. Custodial risk is the risk that in the event of a bank failure, the Medical Center's deposits may not be returned to it. The Medical Center's bank balance of

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

NOTES TO FINANCIAL STATEMENTS
(Continued)

deposits was \$5,148,931 and \$5,362,032 at June 30, 2008 and 2007, respectively. The bank balances held in cash accounts and a repurchase agreement are either insured by the Federal Deposit Insurance Corporation or collateralized by the Tennessee Bank Collateral Pool and are not subject to custodial risk.

Interest rate risk. For an investment, this is the risk that a change in interest rates will affect the fair market value of investments held. The investment is a certificate of deposit with a local financial institution that matures on August 19, 2008, with a 3.59% fixed rate of interest. The short maturity (182 days) of the CD protects the Medical Center from interest rate risk.

Custodial risk - investments. The Medical Center's investment is subject to custodial risk as follows:

<u>Investments</u>	<u>2008</u>	<u>2007</u>
Insured by the FDIC	\$ 100,000	\$ 100,000
Collateralized	<u>129,106</u>	<u>118,560</u>
	<u>\$ 229,106</u>	<u>\$ 218,560</u>

The Medical Center currently has no formal policy addressing interest rate or custodial risk, except to comply with State statutes.

The carrying amounts of deposits and investments shown above are included in the Medical Center's balance sheet as follows:

	<u>2008</u>	<u>2007</u>
Carrying amount		
Deposits	\$ 4,852,152	\$ 4,064,751
Investments	229,106	218,560
Cash on hand	<u>2,000</u>	<u>1,800</u>
	<u>\$ 5,083,258</u>	<u>\$ 4,285,111</u>
Included in the following balance sheet captions		
Cash	\$ 4,829,700	\$ 2,795,590
Internally designated for capital acquisition	229,106	218,560
Patient trust funds	22,956	22,669
Activity funds	1,496	1,577
Prepaid expenses	<u>--</u>	<u>1,246,715</u>
	<u>\$ 5,083,258</u>	<u>\$ 4,285,111</u>

NOTE C - NET PATIENT SERVICE REVENUE

The Medical Center has agreements with third-party payors that provide for payments to the Medical Center at amounts different from its established rates. Contractual adjustments under third-

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

NOTES TO FINANCIAL STATEMENTS
(Continued)

party reimbursement programs represent the difference between the Medical Center's established rates for services and amounts reimbursed by third-party payors. The Hospital obtained critical access status effective February 1, 2005. A summary of the basis of reimbursement with major third-party payors follows.

Medicare. Inpatient acute care services, outpatient services, inpatient nonacute services, and medical education costs related to Medicare beneficiaries are paid based upon a cost reimbursement methodology. The Medical Center is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Medical Center and review by the Medicare fiscal intermediary.

TennCare. Inpatient acute care services and outpatient service costs related to TennCare program beneficiaries are paid based upon a cost reimbursement methodology. The Medical Center is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Medical Center and review by the TennCare fiscal intermediary.

Medicaid - Intermediate Care. The Medicaid program reimburses the Medical Center for services rendered to Medicaid nursing home beneficiaries based on a prospective per diem rate established by the Medicaid program. The per diem rate established by Medicaid is based on the prior years' cost, subject to a maximum per diem rate set by the State of Tennessee.

Others. The Medical Center has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the Medical Center under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively-determined daily rates.

NOTE D - INVENTORIES

Inventories on June 30, 2008 and 2007, consist of the following.

	<u>2008</u>	<u>2007</u>
Pharmacy	\$ 112,885	\$ 91,963
General supplies	91,087	76,049
Dietary	10,653	18,833
Laboratory	29,934	25,796
X-ray	18,593	16,939
Surgery	<u>156,404</u>	<u>100,187</u>
	<u>\$ 419,556</u>	<u>\$ 329,767</u>

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

NOTES TO FINANCIAL STATEMENTS
(Continued)

NOTE E - INTERNALLY DESIGNATED FOR CAPITAL ACQUISITIONS CASH AND INVESTMENTS

During 2004, the Medical Center received an unrestricted contribution from an anonymous private donor. The Board of Trustees has designated the money, invested in a CD at a local bank, for the creation of a health education library.

NOTE F - CAPITAL ASSETS

A summary of changes in capital assets follows.

	<u>2007</u>	<u>Additions</u>	<u>Retirements</u>	<u>2008</u>
Land	\$ 2,362,514	\$ --	\$ --	\$ 2,362,514
Land improvements	79,066	--	13,115	65,951
Buildings and improvements	5,075,155	22,461,843	61,014	27,475,984
Major moveable equipment	7,600,151	4,561,734	1,377,087	10,784,798
Fixed equipment	1,272,258	--	330,733	941,525
Construction in progress	20,707,872	1,784,276	22,461,842	30,306
Totals at historical cost	<u>37,097,016</u>	<u>28,807,853</u>	<u>24,243,791</u>	<u>41,661,078</u>
Less accumulated depreciation for:				
Land improvements	68,764	1,537	13,115	57,186
Buildings and improvements	3,429,768	610,860	61,014	3,979,614
Major moveable equipment	5,351,016	1,005,226	1,377,087	4,979,155
Fixed equipment	1,088,837	14,745	330,733	772,849
Total accumulated depreciation	<u>9,938,385</u>	<u>1,632,368</u>	<u>1,781,949</u>	<u>9,788,804</u>
Property and equipment, net	<u>\$27,158,631</u>	<u>\$27,175,485</u>	<u>\$22,461,842</u>	<u>\$31,872,274</u>
	<u>2006</u>	<u>Additions</u>	<u>Retirements</u>	<u>2007</u>
Land	\$ 2,362,514	\$ --	\$ --	\$ 2,362,514
Land improvements	79,066	--	--	79,066
Buildings and improvements	5,075,155	--	--	5,075,155
Major moveable equipment	7,077,893	522,258	--	7,600,151
Fixed equipment	1,272,258	--	--	1,272,258
Construction in progress	1,611,315	19,096,557	--	20,707,872
Totals at historical cost	<u>17,478,201</u>	<u>19,618,815</u>	<u>--</u>	<u>37,097,016</u>
Less accumulated depreciation for:				
Land improvements	66,869	1,895	--	68,764
Buildings and improvements	3,288,388	141,380	--	3,429,768
Major moveable equipment	4,854,381	496,635	--	5,351,016
Fixed equipment	1,064,752	24,085	--	1,088,837
Total accumulated depreciation	<u>9,274,390</u>	<u>663,995</u>	<u>--</u>	<u>9,938,385</u>
Property and equipment, net	<u>\$ 8,203,811</u>	<u>\$18,954,820</u>	<u>\$ --</u>	<u>\$27,158,631</u>

Amortization of assets acquired under capital lease obligations is included in depreciation expense.

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

NOTES TO FINANCIAL STATEMENTS
(Continued)

The Medical Center has constructed a new facility. At June 30, 2007, approximately \$5,000,000 remained outstanding under contracts. A portion of the amounts paid under these contracts was placed in escrow accounts in the Medical Center and the contractors' names until construction was complete. At June 30, 2007, these deposits totaled \$1,246,715 and were included in prepaid expenses on the balance sheet. Construction in progress included capitalized interest of \$340,208 at June 30, 2007. Buildings and improvements includes capitalized interest of \$464,765 at June 30, 2008.

A portion of the original Medical Center building is being used for the Nursing Home. Building improvements and equipment with a carrying value of \$1,048,349 are idle at June 30, 2008, awaiting a decision on final disposition of the building.

NOTE G - OTHER ASSETS

The Medical Center pays various fees and expenses to and on behalf of physicians who are recruited to practice at the Medical Center. These expenses are recorded as assets and are amortized over the terms of the physicians' contracts. At June 30, 2008 and 2007, respectively, the assets totaled \$370,596 and \$344,422, net of accumulated amortization.

Other assets also include various lease deposits and prepayments totaling \$25,129 and \$25,054 at June 30, 2008 and 2007, respectively.

NOTE H - LONG-TERM DEBT

	<u>2008</u>	<u>2007</u>
Amounts due Rhea County, a related party:		
Note payable for continuing expansion		
and renovation of facilities (RC note 2)	\$ --	\$ 138,512
Loan agreement	24,100,000	18,877,386
Capital lease obligation #1 at an imputed		
interest rate of 9.6%	302,394	374,969
Capital lease obligation #2 at an imputed		
interest rate of 4.1%	685,262	--
	<u>25,087,656</u>	<u>19,390,867</u>
Less current maturities of long-term debt	<u>230,138</u>	<u>210,471</u>
Long-term debt, net of current maturities	<u>\$24,857,518</u>	<u>\$19,180,396</u>

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

NOTES TO FINANCIAL STATEMENTS
(Continued)

On December 11, 1997, the County authorized the Medical Center to borrow from them up to \$1,100,000 for continuing expansion and renovation projects. At June 30, 2001, no further draws were permitted. The outstanding principal matured on December 11, 2000, and was renewed for an additional three years. When it matured on December 11, 2003, it was renewed for an additional three years, with no further extensions available. The debt is due in annual installments of at least one-ninth of the principal outstanding. The notes carry a variable interest rate from 3.90% to 4.55%. The notes are unsecured.

The Public Building Authority of the County of Montgomery, Tennessee issued its "Adjustable Rate Pooled Financing Revenue Bonds, Series 2004" on July 1, 2004, and loaned \$24,100,000 of the proceeds to the Medical Center under a loan agreement with terms substantially identical to terms of the Bonds. The bonds mature on various dates from May 25, 2010 through May 25, 2033. The proceeds of the Bonds were deposited with the lender to be disbursed as needed for construction of the new facility. At June 30, 2008, the entire \$24,100,000 has been drawn from the funds reserved in the Medical Center's name.

Principal payments will be made annually as they become due. Interest payments are due monthly. Interest is calculated daily as set forth in the loan agreement (2.50% at June 30, 2008).

The loan agreement is secured by the property purchased and constructed with the proceeds of the loan agreement.

Capital lease obligation #1 requires monthly installments of \$7,657, including interest, until February 2012. The obligation is secured by a CT system with a cost of \$398,580 and a carrying value of \$285,649 at June 30, 2008.

Capital lease obligation #2 requires monthly installments of \$14,970, including interest, until August 2012. The obligation is secured by an MRI system with a cost of \$808,468 and a carrying value of \$673,723 at June 30, 2008.

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

NOTES TO FINANCIAL STATEMENTS
(Continued)

Scheduled payments on long-term debt are as follows.

<u>Year Ending June 30</u>	<u>Long Term Debt</u>		<u>Capital Lease Obligations</u>	
	<u>Principal</u>	<u>Interest*</u>	<u>Principal</u>	<u>Interest</u>
2009	\$ --	\$ 602,500	\$ 230,138	\$ 41,374
2010	691,000	585,225	241,263	30,257
2011	713,000	567,400	252,930	18,591
2012	735,000	549,025	233,888	7,006
2013	758,000	530,075	29,437	157
2014-2018	4,154,000	2,345,150	--	--
2019-2023	4,840,000	1,775,500	--	--
2024-2028	5,640,000	1,111,750	--	--
2029-2033	6,569,000	338,450	--	--
	<u>\$24,100,000</u>	<u>\$ 8,405,075</u>	<u>\$ 987,656</u>	<u>\$ 97,385</u>

*Future interest payments are based on the loan amounts outstanding and interest rates in effect at June 30, 2008, and do not necessarily represent the payments that will be required.

Activity for long-term debt for 2008 and 2007 follows:

	<u>Balance at June 30, 2007</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance at June 30, 2008</u>	<u>Amounts Due Within One Year</u>
Amounts due to Rhea County, a related party					
RC note 2	\$ 138,512	\$ --	\$ 138,512	\$ --	\$ --
Bonds payable	18,877,386	5,222,614	--	24,100,000	--
Capital lease #1	374,969	--	72,575	302,394	76,474
Capital lease #2	--	808,468	123,206	685,262	153,664
Total long-term debt	<u>\$19,390,867</u>	<u>\$ 6,031,082</u>	<u>\$ 334,293</u>	<u>\$25,087,656</u>	<u>\$ 230,138</u>
	<u>Balance at June 30, 2006</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance at June 30, 2007</u>	<u>Amounts Due Within One Year</u>
Amounts due to Rhea County, a related party					
RC note 2	\$ 265,000	\$ --	\$ 126,488	\$ 138,512	\$ 138,512
Bonds payable	1,682,133	17,195,253	--	18,877,386	--
Capital lease #1	--	398,580	23,611	374,969	71,959
Total long-term debt	<u>\$ 1,947,133</u>	<u>\$17,593,833</u>	<u>\$ 150,099</u>	<u>\$19,390,867</u>	<u>\$ 210,471</u>

NOTE I - ACCRUED LEAVE

Medical Center employees are paid for vacation and absence due to sickness by a prescribed formula based on length of service. The costs of these compensated absences are accrued as earned. The accumulated vacation and sick leave benefits accrued totaled \$263,728 and \$256,859 for 2008 and 2007, respectively, and are included with accrued payroll in current liabilities.

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

NOTES TO FINANCIAL STATEMENTS
(Continued)

NOTE J - CHARITY CARE

The amount of charges forgone for services and supplies furnished under the Medical Center's charity care policy during the years ended June 30, 2008 and 2007, was \$379,219 and \$271,227 respectively.

NOTE K - PENSION PLANS

Effective January 1, 1990, Rhea County Government and related entities including the Medical Center joined the Tennessee Consolidated Retirement System (TCRS), a multiple-employer Public Employee Retirement System (PERS). All full-time personnel employed at or after January 1, 1990, are required to participate in the Tennessee Consolidated Retirement System Pension Plan. The Medical Center contributes the employer's share of pension contributions of 3%, and the employees are required to contribute 5% of their salaries to the plan. Past service costs as of January 1, 1990, were required to be funded upon entering the plan. The Medical Center has chosen to amortize these costs over a thirty-year period by increasing its contribution rate, which is currently 8.72%. Contributions by the Medical Center totaled \$601,734 and \$575,553 in 2008 and 2007, respectively. Information in regard to funding status, contribution requirements, and trends appear in the financial statements of Rhea County and cannot be separately identified for the Medical Center.

NOTE L - NET WORKING CAPITAL

Net working capital at June 30, 2008 and 2007, was \$7,685,794 and \$5,427,149, respectively.

NOTE M - DESIGNATED NET ASSETS

Net assets reported in 2008 and 2007 include \$229,106 and \$218,560, respectively, which has been designated by the Medical Center's Board of Trustees for capital acquisitions. Designated funds remain under the control of the Board of Trustees, which may at its discretion later use the funds for other purposes.

NOTE N - COMMITMENTS AND CONTINGENCIES

Operating leases. Leases that do not meet the criteria for capitalization are classified as operating leases with related rentals charged to operations as incurred.

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

NOTES TO FINANCIAL STATEMENTS
(Continued)

The following is a schedule by year of future minimum lease payments under operating leases as of June 30, 2008, that have initial or remaining lease terms in excess of one year.

<u>Year Ending June 30,</u>	<u>Minimum Lease Payment</u>
2009	\$ 52,367
2010	<u>24,500</u>
Total minimum lease payments	\$ <u>76,867</u>

Rental expense included in operations amounted to \$153,970 and \$194,986 in 2008 and 2007, respectively.

Professional liability insurance. The Medical Center is insured for professional liability under a claims-made policy with an independent insurance carrier. The policy covers all claims reported to the carrier during the coverage period. Premiums are determined by a variety of factors related to the Medical Center.

Management agreement. An extension of a management agreement between the Medical Center and Quorum Health Resources, Inc., (Quorum) was signed on December 18, 2001, with effective dates of March 1, 2002 through February 28, 2009. The annual fee is \$203,295 for the contract year beginning March 1, 2002, increases \$7,500 per year, and is payable in equal monthly installments. Management services in addition to the fixed fee services are provided by Quorum as needed at varying rates. The total management fees paid to Quorum were \$252,286 and \$238,243 in 2008 and 2007, respectively.

The management services provided pursuant to the fixed fee include budget assistance, accounting supervision, human resources consultations, and access to a Quorum sponsored volume purchasing program. Certain 'administrative fees' may be paid to Quorum by outside vendors that sell goods and services to the Medical Center. The administrative fee payable to Quorum by these outside vendors is equal to 3% or less of the purchase price of the goods or services purchased from the vendor by the Medical Center. The contract provides that these fees shall be disclosed to the Medical Center annually in writing.

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

NOTES TO FINANCIAL STATEMENTS
(Continued)

Quorum also provides certain 'key personnel' to the Medical Center who are Quorum employees. The Medical Center reimburses Quorum for the costs and expenses (including but not limited to salaries, taxes, fringe benefits, and business expenses) of providing these key personnel as invoiced by Quorum. These reimbursements are in addition to the fixed annual management fee described above. The amount paid to Quorum for administrative compensation and other services was \$349,019 and \$332,008 for 2008 and 2007, respectively.

Litigation. The Medical Center is subject to claims and suits which arise in the ordinary course of business. In the opinion of management, the ultimate resolution of such pending legal proceedings has been adequately provided for in its financial statements, and will not have a material effect on the Medical Center's results of operations or financial position.

NOTE O - RELATED PARTY

As stated in Note H, the Medical Center borrows money from Rhea County, a related party. Interest paid by Rhea County on debt issued for the Medical Center is passed through to the Medical Center. The Medical Center paid \$3,071 and \$11,988 in 2008 and 2007, respectively, to the County for interest.

NOTE P - CONCENTRATIONS OF CREDIT RISK

The Medical Center is located in Rhea County, Tennessee. The Medical Center grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at June 30, 2008 and 2007, was as follows.

	<u>2008</u>	<u>2007</u>
Medicare	24%	21%
Medicaid/TennCare	15	14
Blue Cross	10	9
Commercial	11	14
Private pay	<u>40</u>	<u>42</u>
	<u>100%</u>	<u>100%</u>

SUPPLEMENTARY INFORMATION

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

SCHEDULE 1 - PATIENT SERVICE REVENUE

Years Ended June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
DAILY PATIENT SERVICES		
Routine care	\$ 6,660,307	\$ 6,056,967
Intensive care unit	<u>169,660</u>	<u>115,079</u>
TOTAL DAILY PATIENT SERVICES	<u>6,829,967</u>	<u>6,172,046</u>
OTHER NURSING SERVICES		
Operating and recovery rooms	947,036	941,170
Emergency room	6,333,528	5,535,891
Central supply	<u>1,112,578</u>	<u>993,472</u>
TOTAL OTHER NURSING SERVICES	<u>8,393,142</u>	<u>7,470,533</u>
OTHER PROFESSIONAL SERVICES		
Laboratory	5,545,252	4,759,721
Electrocardiology	402,099	381,186
Radiology	2,217,421	2,029,800
Cardiac rehab	74,701	82,617
Pharmacy	2,361,106	2,513,652
Anesthesiology	113,905	105,453
Physical therapy	1,488,386	1,453,645
Occupational therapy	184,870	5,046
Respiratory therapy	909,854	880,799
Intravenous therapy	545,239	479,792
Nuclear medicine	2,258,256	2,223,413
Vascular studies	326,269	299,484
CT scans	8,306,232	6,715,007
Bone densitometry	90,290	91,376
Industrial nursing	<u>290,192</u>	<u>254,747</u>
TOTAL OTHER PROFESSIONAL SERVICES	<u>25,114,072</u>	<u>22,275,738</u>
TOTAL PATIENT SERVICE REVENUE	<u>\$40,337,181</u>	<u>\$35,918,317</u>

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

SCHEDULE 2 - PROVISION FOR CONTRACTUAL ADJUSTMENTS AND BAD DEBTS

Years Ended June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Medicare and Medicaid	\$10,675,540	\$10,580,798
Blue Cross	2,430,164	2,227,947
Employee discounts	22,933	13,906
Other policy discounts	1,822,167	1,502,749
Bad debts	<u>3,356,243</u>	<u>2,841,987</u>
TOTAL CONTRACTUAL ADJUSTMENTS	<u>\$18,307,047</u>	<u>\$17,167,387</u>

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

SCHEDULE 3 - OTHER OPERATING REVENUE

Years Ended June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Patient histories	\$ 360	\$ 620
Rental revenue	92,122	92,149
Cafeteria revenue	52,269	54,987
Vending revenue	3,492	3,429
Miscellaneous revenue	<u>63,302</u>	<u>25,652</u>
TOTAL OTHER OPERATING REVENUE	\$ <u>211,545</u>	\$ <u>176,837</u>

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

SCHEDULE 4 - SALARIES AND BENEFITS

Years Ended June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
NURSING SERVICES		
Nursing	\$ 2,604,694	\$ 2,442,091
Intensive care unit	102,950	81,977
Operating and recovery rooms	287,152	240,415
Emergency room	1,249,876	971,579
Central supply	<u>37,041</u>	<u>27,335</u>
TOTAL NURSING SERVICES	<u>4,281,713</u>	<u>3,763,397</u>
OTHER PROFESSIONAL SERVICES		
Laboratory	481,458	432,653
Radiology	489,088	424,707
Cardiac rehab	44,328	39,109
Pharmacy	181,940	187,729
Respiratory therapy	285,249	238,560
Nuclear medicine	252,562	234,440
CT scans	55,042	55,456
Clinic	38,621	28,046
Industrial nursing	178,483	193,642
MRI	<u>53,436</u>	<u>--</u>
TOTAL OTHER PROFESSIONAL SERVICES	<u>2,060,207</u>	<u>1,834,342</u>
GENERAL SERVICES		
Dietary	432,024	349,652
Building operation and maintenance	167,873	159,377
Housekeeping	266,750	195,143
Laundry	15,613	24,500
Medical records	225,710	217,924
Materials management	38,985	37,800
Activities	<u>75,620</u>	<u>69,514</u>
TOTAL GENERAL SERVICES	<u>1,222,575</u>	<u>1,053,910</u>
ADMINISTRATIVE AND FISCAL SERVICES		
Administrative and business office	<u>3,340,469</u>	<u>3,005,644</u>
TOTAL SALARIES AND BENEFITS	<u>\$10,904,964</u>	<u>\$ 9,657,293</u>

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

SCHEDULE 5 - MEDICAL SUPPLIES AND DRUGS

Years Ended June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
NURSING SERVICES		
Nursing	\$ 63,302	\$ 49,119
Intensive care unit	26	221
Operating and recovery rooms	--	13,865
Emergency room	54,626	43,534
Central supply	<u>373,227</u>	<u>300,937</u>
TOTAL NURSING SERVICES	<u>491,181</u>	<u>407,676</u>
OTHER PROFESSIONAL SERVICES		
Laboratory	379,771	283,733
Radiology	12,510	44,610
Cardiac rehab	3,191	2,709
Pharmacy	465,889	583,421
Physical therapy	4,799	4,228
Respiratory therapy	43,070	47,933
Electrocardiology	--	8
Intravenous therapy	17,969	15,958
Nuclear medicine	82,401	89,698
CT scans	70,307	98,001
Clinic	169	770
Industrial nursing	<u>532</u>	<u>109</u>
TOTAL OTHER PROFESSIONAL SERVICES	<u>1,080,608</u>	<u>1,171,178</u>
TOTAL MEDICAL SUPPLIES AND DRUGS	\$ <u>1,571,789</u>	\$ <u>1,578,854</u>

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

SCHEDULE 6 - OTHER SUPPLIES

Years Ended June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
NURSING SERVICES		
Nursing	\$ 8,766	\$ 7,297
Operating and recovery rooms	3,657	1,829
Emergency room	13,360	5,749
Central supply	<u>2,274</u>	<u>1,776</u>
TOTAL NURSING SERVICES	<u>28,057</u>	<u>16,651</u>
OTHER PROFESSIONAL SERVICES		
Laboratory	3,966	1,442
Radiology	2,612	207
Cardiac rehab	402	365
Pharmacy	1,070	1,908
Physical therapy	1,630	1,651
Respiratory therapy	741	487
Nuclear medicine	1,953	11,240
CT scans	17,478	933
Clinic	616	762
Industrial nursing	24,099	16,309
Outpatient	<u>--</u>	<u>25</u>
TOTAL OTHER PROFESSIONAL SERVICES	<u>54,567</u>	<u>35,329</u>
GENERAL SERVICES		
Dietary	395,185	353,310
Building operation and maintenance	39,189	24,179
Housekeeping	72,919	63,419
Laundry	4,885	3,349
Medical records	5,226	5,863
Professional building	--	8
Activities	2,809	3,521
Gift shop	<u>41,261</u>	<u>--</u>
TOTAL GENERAL SERVICES	<u>561,474</u>	<u>453,649</u>
ADMINISTRATIVE AND FISCAL SERVICES		
Administrative and business office	<u>92,444</u>	<u>61,946</u>
TOTAL OTHER SUPPLIES	\$ <u><u>736,542</u></u>	\$ <u><u>567,575</u></u>

RHEA MEDICAL CENTER (A COMPONENT UNIT OF
RHEA COUNTY, TENNESSEE)

SCHEDULE 7 - OTHER EXPENSES

Years Ended June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
NURSING SERVICES		
Nursing	\$ 638,032	\$ 404,412
Intensive care unit	19,183	15,392
Operating and recovery rooms	77,124	35,017
Emergency room	180,835	89,666
Central supply	<u>5,967</u>	<u>957</u>
TOTAL NURSING SERVICES	<u>921,141</u>	<u>545,444</u>
OTHER PROFESSIONAL SERVICES		
Laboratory	181,968	170,194
Radiology	128,325	76,562
Cardiac rehab	6,643	10,888
Pharmacy	44,474	29,055
Anesthesiology	53,729	42,000
Physical therapy	528,081	490,245
Occupational therapy	68,062	--
Respiratory therapy	68,797	7,824
Nuclear medicine	65,970	61,629
CT scans	139,484	464,168
Clinic	6,859	5,342
Bone densitometry	6,207	5,358
Industrial nursing	<u>44,953</u>	<u>27,443</u>
TOTAL OTHER PROFESSIONAL SERVICES	<u>1,343,552</u>	<u>1,390,708</u>
GENERAL SERVICES		
Dietary	45,307	31,551
Building operation and maintenance	877,772	467,045
Housekeeping	26,393	15,745
Laundry	126,835	148,271
Medical records	45,571	34,220
Materials management	1,259	--
Professional building	22,394	12,092
Activities	<u>3,297</u>	<u>2,310</u>
TOTAL GENERAL SERVICES	<u>1,148,828</u>	<u>711,234</u>
ADMINISTRATIVE AND FISCAL SERVICES		
Administrative and business office	<u>1,662,081</u>	<u>1,474,441</u>
TOTAL OTHER EXPENSES	<u>\$ 5,075,602</u>	<u>\$ 4,121,827</u>

**BURK:PEARLMAN
NEBBEN & HUGGINS, PLLC**
CERTIFIED PUBLIC ACCOUNTANTS

7030 LEE HIGHWAY • SUITE 202 • CHATTANOOGA, TENNESSEE 37421
TELEPHONE: (423) 490-8500 • FAX: (423) 490-1400
admin@bphcpa.com

REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER
MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Board of Trustees of
Rhea Medical Center (a component unit of Rhea County, Tennessee)

We have audited the financial statements of Rhea Medical Center (a component unit of Rhea County, Tennessee) (the Medical Center) as of and for the year ended June 30, 2008 and have issued our report thereon dated November 24, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Medical Center's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Medical Center's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Medical Center's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Medical Center's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the

Medical Center's financial statements that is more than inconsequential will not be prevented or detected by the Medical Center's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Medical Center's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Rhea Medical Center's (a component unit of Rhea County, Tennessee) financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information of the Board of Trustees, management, the State of Tennessee, and the Rhea County Government and is not intended and should not be used by anyone other than these specified parties.

Burb, Pearlman, Nelson & Huggins, PLLC

Chattanooga, Tennessee
November 24, 2008